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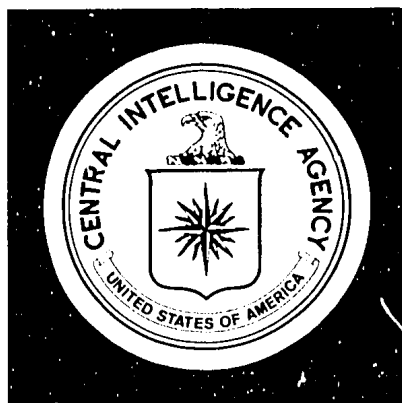
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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Jordan: Shaky Budgetary Position

USAID review completed

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
February 1973

INTELLIGENCE MEMORANDUM

JORDAN: SHAKY BUDGETARY POSITION

SUMMARY

1. Jordan's budgetary problems could undermine an otherwise favorable economic outlook. Domestic production in agriculture, industry, and mining is rising after several years of stagnation. An across-the-board expansion of capacity is being spurred by the new Three-Year Development Plan (1973-75). But the maintenance of the current high level of business confidence and economic activity depends on the ability of the government to cope with its perennial budget deficit.

2. The 1973 budget envisions US \$279 million in expenditures and only \$124 million in receipts – leaving a gap of \$155 million to be filled by foreign aid, domestic borrowing, and the carryover of certain obligations into 1974.

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3. If budget support payments from the United States or well-to-do Arab states fall substantially short of Jordanian plans, the result presumably would be a combination of tighter exchange controls, a drop in foreign exchange reserves, and reduced allocations to economic development projects. Non-development allocations are already at minimum levels. Further cuts in spending – particularly military – would be difficult and would pose sensitive political issues.

4. Jordan, with its large foreign exchange reserves, would be able to handle a small shortfall in foreign aid if there were firm expectations that foreign support would be forthcoming in the event of serious difficulties.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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CONFIDENTIAL**DISCUSSION****Background**

5. Jordan¹ emerged as an independent state in 1946, with few natural resources, little industry, and a population consisting of one-third refugees. In spite of these weaknesses, economic progress was made by the judicious use of large amounts of foreign aid, primarily from the United States and the United Kingdom. During 1954-66, per capita gross national product (GNP) increased 9% a year on the average, reaching \$250 in 1966.

6. As a result of the June 1967 war, large numbers of refugees moved into the East Bank, the important domestic revenues from the West Bank were lost, and factories and other businesses on the East Bank lost a sizable part of their markets. In 1968-69, rising fedayeen activity brought Israeli retaliation and almost halted farming in the East Ghor irrigation area. Even so, the economy of the truncated Jordanian state showed surprising resiliency and began to revive in 1968-69. By early 1970, however, fedayeen activity inside Jordan had increased to such a level that many businesses could no longer carry on.

7. In September 1970, Jordan declared war on the fedayeen. Fighting erupted in Amman and major cities in the country, with the fedayeen being driven from urban areas. This action was condemned by other Arab countries, and Jordan lost about \$65 million in grant aid from Libya and Kuwait. Further action against the fedayeen was taken in July 1971, ending their overt presence in Jordan. In response, Egypt broke off diplomatic relations, and Syria closed its border and denied the use of its airspace to Jordanian aircraft. The closing of the Syrian border brought a major portion of Jordan's exports to a standstill.

Rising Industrial Output

8. Jordan's economy, since the neutralization of the fedayeen, has been on the upswing. Advances have been made in all sectors of the economy. Industrial production reached a record level in 1971 and continued its strong advance in 1972, as follows (1966 = 100):

1. Unless otherwise specified, the term Jordan refers to the territory under the de facto control of the government of Jordan. Since the 1967 Arab-Israeli war, Jordan controls only territory east of the Jordan River.

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1967	91.1
1968	92.7
1969	110.8
1970	95.9
1971	113.7
1972	138.7 (10 months)

9. The rise in industrial output has been led by petroleum products, leather, textiles, detergents, and cement. Most of the rise is attributable to the record level of private investment, both domestic and foreign. Another factor has been the availability of considerable unused capacity, which was greatly reduced in 1972. New industrial capacity continues to be added - for example, in petroleum and cement - and an air of optimism now prevails in Amman's business community. Notwithstanding the recent percentage advances, industry and mining still represent only 11% of gross domestic product (GDP).

Gradual Modernization in Agriculture

10. Agricultural output also increased substantially in 1972. For the first time since 1966, Jordan did not have to import large quantities of PL-480 wheat. The agricultural sector has been receiving most of the national development funds. The government has been increasing agricultural credit and extension services and has been eliminating duties on fertilizers and insecticides. Mechanization is increasing throughout the country. For instance, one Jordanian implement dealer, who had record sales in 1972, has ordered more tractors in 1973 than were imported by all dealers in 1972.

11. In the East Ghor region, the largest irrigated area in Jordan, production is rapidly increasing. Major government efforts to improve irrigation here began soon after the removal of fedayeen from the area in 1970. In early 1972 a US AID team assisted the Jordanian government in formulating land use policies, including conservation and reclamation plans. Large numbers of tractors were added in the area in 1972. Gains from these measures should accrue for some years to come.

12. For the moment, agriculture is experiencing a setback. Present crops of vegetables and bananas in the East Ghor area have been hit by heavy frosts. Dryland grain farming also has suffered from low rainfall early this winter. As a result, harvests in 1973 will probably be below normal. These difficulties should be temporary.

CONFIDENTIAL**Good Prospects for Services**

13. The service sector should expand substantially in the near term, with prospects for increased government expenditures and greater earnings from tourism. Slightly more than half of the output of the service sector is generated by government spending, primarily on education and health. Most of these services are directly related to the government budget and are slated to increase. Some \$31 million in development funds in the Three-Year Development Plan are allocated to education and about \$4 million to health.

14. Of the remaining services, tourism offers the best prospect for important increases. Receipts from tourism amounted to \$7 million in 1971 and could easily reach \$25 million by 1975. Amman now has only one first-class hotel, which has about 140 rooms with another 100 rooms to be added shortly. Four more large hotels are in the offing. Construction is beginning on a 250-room Holiday Inn in Amman. A second Holiday Inn is on the drawing board for Aqaba. Another hotel, not first class, is being built near Sports City in Amman. A fourth hotel of about 250 rooms is being planned in the vicinity of the Amman Holiday Inn.

Three-Year Development Plan

15. The Three-Year Development Plan calls for ambitious percentage growth rates throughout the economy, as follows (average annual planned rate of growth, 1973-75):

	Percent
GDP	8.0
Agriculture	6.3
Industry and mining	13.9
Construction	11.1
Transportation	2.9
Public administration and defense	8.2
Services	5.7

16. Although the plan provides for investments only for the East Bank, it calls for an increase in GDP for the entire country of 26% in three years -- from an estimated \$608 million in 1972 to \$765 million in 1975. Most of the government investment is in "infrastructure" projects such as dams, irrigation canals, roads, and the railroad, some of which will not be completed during the plan period.

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17. Investment under the Three-Year Development Plan is to total about \$500 million -- 56% by the government and 44% by the private sector. Foreign assistance is projected at \$195 million, made up of \$45 million in economic and technical assistance and \$150 million in development loans, of which about \$100 million has been pledged by the West German, UK, and US governments; the Kuwait Fund; the World Bank; and others. The US share is about \$11 million. Investment in agriculture is to feature irrigation projects, with additional provision for forestation, soil conservation, and extension services. Among the industrial projects, most of which will be financed jointly by the government and private interests, are: a ceramics factory, a glass factory, a phosphoric acid plant, the expansion of phosphate mining facilities, and the initiation of copper and manganese mining. The biggest transportation project is the Maan-Aqaba rail line, which will link Aqaba, Jordan's only port, with the two major manufacturing centers of Amman and Zarka. Table 1 supplies a breakdown of investment under the Three-Year Development Plan, and Table 2 gives the percentage breakdown of GDP by economic sector for 1971, 1972, and 1975.

The Budget*Past Record*

18. Immediately prior to the June 1967 war, Amman was spending roughly \$50 million more each year than it collected in domestic revenues. The deficit was made up by grant aid, mostly from the United States and the United Kingdom. The budget deficit tripled to about \$150 million annually in 1968-70, the three years after the war. In this latter period, budget support grants covered roughly three-fourths of the deficit and domestic borrowing the remainder. Almost all budget aid in these years came from Kuwait, Libya, and Saudi Arabia under the terms of the September 1967 Khartoum Agreement. From September 1967 until September 1970, when heavy fighting developed between Husayn's government and the fedayeen, Arab aid averaged about \$105 million annually.

19. After the 1970 flareup, Kuwait and Libya suspended aid payments of \$39 million and \$25 million, respectively, in September 1970. Kuwait resumed payments in December, only to suspend them again in January 1971. In 1971 the United States once again became the major source of budget support, providing about \$48 million, of which \$15 million was to be used to cover a part of the deficit carried over into 1972. Khartoum aid in 1971 amounted to only \$42 million, compared with \$93 million in 1970. Another \$13 million in aid came from other sources. In 1972 the US government provided \$50 million in budget support, and Khartoum

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Table 1

Jordan: Planned Public and Private Investment by Sector^a
1973-75

	<i>Million US \$</i>			
	<i>Public</i>	<i>Private</i>	<i>Total Investment</i>	<i>Percent of Total</i>
Economic sectors	201.2	118.1	319.3	63.7
Agriculture	25.0	11.4	36.4	7.3
Irrigation	41.0	--	41.0	8.2
Industry and mining	16.2	56.9	73.1	14.6
Tourism and antiquities	5.9	14.2	20.1	4.0
Electricity	16.0	11.4	27.4	5.5
Transportation	77.9	22.4	100.3	20.0
Communication	18.8	--	18.8	3.8
Trade	0.4	1.8	2.2	0.4
Social sectors	77.7	104.3	181.9	36.3
Education and youth care	21.5	9.1	30.6	6.1
Health	2.5	1.7	4.1	0.8
Work and social affairs	3.9	0.2	4.1	0.8
Housing and government buildings	7.6	88.1	97.7	19.5
Municipal and rural affairs	39.5	1.8	41.3	8.2
Other	0.7	3.4	4.1	0.8
Total investments	278.9	222.4	501.2	100.0

a. Because of rounding, components may not add to the totals shown.

Table 2

Jordan: Percentage Distribution of Gross
Domestic Product,^a by Sector

	<i>Percent</i>		
	<i>1971</i>	<i>1972</i>	<i>1975</i>
Agriculture	17.9	18.0	17.1
Industry and mining	10.3	11.0	13.0
Electricity and water supply	1.3	1.3	1.7
Construction	4.9	5.3	5.8
Transportation	7.9	7.8	6.8
Trade	19.1	18.7	18.5
Banking	2.1	2.2	2.0
Ownership of dwellings	6.9	6.8	6.8
Public administration and defense	18.8	18.2	18.3
Services	10.8	10.7	10.0

a. Factor cost.

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aid payments amounted to \$64 million (including some \$20 million in advanced 1973 payments). Another \$4 million came from other sources.

The 1973 Deficit

20. Jordan's 1973 budget² again will show a large deficit of about \$155 million, before the receipt of foreign aid. Budget outlays are projected at \$279 million (including a \$9 million obligation carryover from 1972), an increase of about 8% over that of 1972. Domestic revenue is to rise about 15% to \$124 million. Development spending is to grow by 130% to about \$52 million (including \$8.7 million of 1972 obligations), the largest allocation to economic development since 1967. To accommodate the rise in economic development expenditures, other spending is to be held down. Military spending, about two-fifths of the total budget, is to increase by only 4% over the 1972 budget. This level is about 5% less than was actually spent on defense in 1972.

21. The 1973 budget calls for \$112 million in foreign assistance without pinpointing the sources of the aid.

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The Saudi Arabian government has given Jordan some hope that it will make four payments in 1973 in addition to the advanced payments, but the outlook is uncertain at best. Other possible sources of aid, such as Abu Dhabi and other Persian Gulf states, are even more doubtful. Abu Dhabi gave Jordan just less than \$10 million for budget support in 1971, but gave nothing in 1972. (For details on the 1973 budget, see Table 3.)

22. If Jordan receives the full amount of foreign budget support projected for 1973, a deficit of about \$43 million will remain to be financed from domestic sources. Jordan could finance this deficit with domestic borrowing and some carryover of obligations into 1974. Domestic borrowing would have to be almost solely through Central Bank advances and short-term loans (only about 2% of government bonds issued in 1972 are held outside the banks), which would inflate the already excessive money supply. Massive budget deficits since the June 1967 war have caused a 70% increase in the money supply. Now that business confidence is being renewed and general economic activity is increasing at a rapid rate, the augmented money holdings will be put to use. The increase in spending has already pushed imports up and will contribute to future pressure on foreign exchange reserves. The cost of living index was up 8% in 1972,

2. The budget excludes both receipts and expenditures of foreign development loans.

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Table 3

Jordan:
Government Expenditures and Receipts

	<i>Million US \$</i>	
	<i>1972 Actual</i>	<i>1973 Budget</i>
Total expenditures	258.0	278.9
Receiving budget	195.9	200.5
Civil service	72.8	81.8
Public security	13.2	14.0
Armed forces	109.9	104.7
Development budget	53.4	69.3
Development expenditures	22.8	43.5
Non-developmental expenditures	30.6	25.8
Foreign debt	9.7	18.2
Domestic debt	3.4	1.7
Other debt payments	6.3	5.9
Emergency expenditures	11.2	a
Obligation carryover	8.7	9.1
Total receipts	238.9	235.8
Domestic	107.8	123.8
Foreign	117.1	112.0
Saudi Arabia ^b	63.5	
US	50.0	
Other	3.6	
Borrowing	14.0	
Remaining deficit	19.1	43.1
Expected additional US aid	10.0	
Carryover into 1973	9.1	

a. Included in 1973 civil service expenditures.

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compared with an annual rate of 4.3% for the period 1970-71. This increased inflation, however, reflects increased import prices resulting from the devaluation of the dinar – which followed the dollar devaluation – relative to the currencies of most of Jordan's suppliers.

Foreign Exchange Reserves

23. Foreign exchange reserves of about \$250 million are sufficient to cover more than 12 months' imports. Given this level of foreign reserves,

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the Central Bank will not feel uneasy about making funds available to the government, up to, say, \$30 million – double the 1972 borrowing. A remaining gap of \$10 million to \$15 million could be covered by obligation carryovers in 1974. Some development obligations will be held over until 1974 in any event as a result of normal project delays. Jordan, however, would be hard pressed to make up substantial shortfalls in projected budget support aid.

24. Even if the projected aid is eventually obtained, Jordan may be forced to draw down foreign exchange reserves in the first half of 1973. No budget support payments from any foreign sources are scheduled before July 1973, except for a possible additional \$10 million in US aid for the 1972 budget.

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foreign exchange reserves could fall in the first six months of 1973 by more than \$50 million. This probably would not seriously damage business confidence, however, if sufficient aid to halt the reserve drain were assured for later in the year and there was a firm expectation that strong foreign support would be forthcoming if serious difficulties arose.

25. Any substantial reduction in the 1973 budgeted expenditures would cause both economic and political problems. Jordan has held down its defense budget for several years by delaying the purchase of military equipment. Rather than being receptive to a cut in funds, the army is likely to put pressure on the King for increased funds, having requested as a minimum budget \$114.5 million, or about \$10 million more than has been allocated. Similarly, cuts in the civil service budget would be difficult because increases have been held down for several years, and most economies already have been made. Reduced allocations for economic development, while possible, would have a serious adverse effect upon private investment. Jordanian businessmen are influenced by the government budget in making major investment decisions. The important aspect is not the size of a budget deficit but rather the ability of the government to proceed with its stated development objectives and to obtain the required support from foreign governments. Furthermore, private businessmen are heavily involved in economic development as participants in joint projects and as suppliers of materials and equipment.

Longer Term Prospects

26. Jordan's dependence on foreign aid through the remainder of the Three-Year Development Plan will remain at least as large as at present. However, the longer term trends are favorable, as domestic reserves have been increasing faster than expenditures and in most years as exports have increased faster than imports. By 1975 or so the budgetary gap and the foreign exchange gap should begin to shrink – if, of course, the security situation does not deteriorate.

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